

## The Consolidation Theory Used in Japan

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# The Consolidation Theory Used in Japan

Le Van Lien

Consolidation accounting standards were revised in Japan in 1997. In this time, The Business Accounting Deliberation Council (BADC) pointed out that “The revised consolidation standards follow mainly the former one; parent company concept”<sup>1)</sup>. In this article, we would like to present, exchange our opinion about which consolidation theory is really used in Japan recently. In order to get this target, the following issues are discussed.

1. Consolidation theories
2. Consolidation theory used in Japan currently.

## 1 . Consolidation theories

One of problem when consolidated financial statements (CFS) are prepared is that for whom preparation of CFS is. If the group has no minority interest, no problem will occur. However, when a subsidiary is owned partially by parent company, for different purposes of related parties that preparation of consolidated financial statements prefers to, the financial information reflected in CFS is not the same. So far, there have been four consolidation concepts; proprietary concept, parent company concept, parent company extension concept and entity concept, which consolidation practice is based on. Each of consolidation theory is summarized briefly below.

### 1.1 Proprietary concept

This concept is based on the proprietary theory, which points out that owners of each business has right and responsibility themselves of business operation legally. In other words, “The assets are assumed to be owned by proprietor and liability are the proprietor’s obligation”<sup>2)</sup>.

How this theory is applied to consolidation accounting practice. The owner in proprietary concept refers to only extent of parent company’s stockholders. Applying this concept to process of preparing CFS is explained as below.

At the time of acquisition, assets and liabilities of subsidiaries owned by parent company are valued at fair value and contained in consolidated balance sheet. Proportion of minority interest is never showed in this financial statement. Consolidation goodwill is determined by difference

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1) 連結財務諸表制度の見直しに関する意見書, 第二部の1の2。

2) Eldon S Hendriken, Michael F Van Breda, Accounting Theory, Irwin, 1922, pp.769-770.

between investment cost of parent company and its proportion in net asset of subsidiaries at fair value.

After acquisition, the principle of proportion is remained constantly; proportion of minority interest is never presented on CFS. Related to unrealized loss or profit generated from inter-transactions, only proportion belonging to parent company is eliminated; whereas, the one belonging to minority interest is regarded as realized loss or profit because minority interest is considered as outsider of consolidation entity.

In conclusion, this concept “...only emphasizing the presentation of percentage of assets, liabilities, revenues, expenses and net income owned by parent company’s stockholders...proportion of minority interest is ignored on consolidated financial statements”<sup>3)</sup>.

## 1.2 Parent company concept

According to parent company concept “If only the holding company’s proportion of the subsidiary’s assets and liabilities are taken up, the truth condition would not be shown because it would appear that the holding company actually owned the assets and owned the liability taken up. The fact that the holding company does not own the assets of the subsidiary nor own the own the liabilities, but has an undivided interest in the net assets of the subsidiary, and this undivided interest cannot be dissociated from nor shown apart from the interest of the minority interest of the minority stockholders if all of the facts are to be apparent”<sup>4)</sup>. Different point between parent concept and proprietary concept is that proportion of net assets at book value of subsidiary belonging to minority interest is also presented on consolidated balance sheet. As parent concept still focuses on parent company’s stockholders, the minority interest’s item is regarded as an outside group and a liability. Applying this concept to process of preparing CFS is explained as follows.

At the time of acquisition, assets and liabilities of consolidated subsidiaries valued at fair value belonging to parent company’s stockholders are contained in consolidated balance sheet. Proportion of minority interest, which is measured by its proportionate share in net assets of consolidated subsidiaries at book value, is also reflected in consolidated balance sheet. Consolidation goodwill is computed by the difference between parent’s investment cost in subsidiary and its proportion in net assets of consolidated subsidiary at fair value.

Under this concept, unrealized profit or loss generated from inter-company transactions, which is allocated for minority interest, is considered as realized profit or realized loss. After the acquisition, minority interest’s proportion increased or decreased is calculated by adding or

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3) 稲垣富士男, 連結財務諸表の基礎, 中央経済社, 1998, p.26.

4) George. Baxter & James C. Spinney, A Closer Look At Consolidated Financial Statements Theory, CA Magazine, January 1975, p.32.

subtracting to its proportion share of net profit or loss presented on subsidiary's income statement. Furthermore, minority interest is presented as a separated liability item on consolidated balance sheet as minority interest is considered as outsider under this concept. Finally, this concept focuses on parent company's stockholders, minority interest is regarded as outsider of the group, consolidated net income does not consist of net income belonging to minority interest; thereof, minority interest's net income is presented in the consolidated income statement as a deductive item.

### 1.3 Parent company extension concept

Parent company extension concept is primitively published in Exposure Draft, which was prepared by Canadian Institute of Chartered Accountants. Grounds of supports for this concept is that investors can understand more financial position and net result of group if they are supplied with CFS, which contain identifiable assets and identifiable liabilities of subsidiaries measured at fair value. Comparison with parent company concept, this concept has got three different points; valuating net assets of subsidiary, measuring minority interest's equity and eliminating inter-transactions.

At the time of acquisition, identifiable assets and liabilities of subsidiaries are valued at the fair market value and they are divided for parent company and minority interest base on proportions of their interests. Consolidation goodwill is measured by difference between parent company's investment cost in subsidiary and net assets at the fair value of subsidiary assigned to parent company. So, there is no consolidation goodwill for minority interest and minority proportion in consolidated subsidiary's net assets is only extended to its identifiable net assets at the fair value.

After acquisition, minority interest's proportion increased or decreased is computed by adding or subtracting to its portion of net profit or loss income presented on consolidated subsidiary's income statement; then adjusting amortization of difference between book value and fair value as well as unrealized profit or loss that are allocated for minority interest. Also, under this concept "Proponents of the parent company extension concept have not provided a rationalization for continuing to relegate minority interest to that "no man's—land" between liabilities and shareholders' equity"<sup>5)</sup>. Moreover, related to inter-company transaction, method of elimination is stated as follows "Where assets are exchanged between members of consolidated group, the Institute seems to prefer a complete elimination of the investor and minority share of any "unrealized" profit or loss arising on exchange. The rational for advocating this 100% elimination is based on an interest in reporting assets at original cost and a concern for the absence of arms-length bargaining"<sup>6)</sup>.

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5) George. Baxter & James C. Spinney, op. cit. p.35.

6) Ibid., p.34.

#### 1.4 Entity concept

This concept (it is also called as economic concept) is based on the entity theory in accounting. According to the entity theory, it emphasizes the related parties; assets of business are considered as assets of entity, liabilities are considered as obligations of the entity. Consolidation under the entity concept treats parent company and minority interests consistently. The entity concept emphasizes control of the whole by a single management. As a result, under this concept; CFS are intended to provide information about a group of legal entities—a parent company and its subsidiaries—operating as a single unit. The assets, liabilities, revenues, expenses, gains, and losses of the various component entities are those of the consolidated entity.

Unless all subsidiaries are wholly owned, consolidated subsidiary's net assets at fair value are divided into two parts; one is owned by parent company's stockholders and the other is owned by minority interest. As shown above, under the entity concept, at the time of acquisition, all of assets are valued at fair value like parent company extension concept, but consolidation goodwill includes those assigned to minority interest.

For method of treating inter-company transactions, because minority interest is a part owner of consolidated assets, their share of inter-company profit in inventories has not being realized. Profit realized and expenses occurred are only extent to transactions with parties outside of the group. Furthermore, in concerned with presentation of minority interest in consolidated balance sheet “when related companies are viewed as parts of such an entity, the minority interest, instead of representing an accountability to an outside group by the parent, represents a part of capital”<sup>7)</sup>.

In conclusion, comparison among consolidation concepts can be expressed on the figure 1<sup>8)</sup>. Nowadays, it is very common that consolidation accounting in practice used in the world is mixed up three consolidation concepts; parent company concept, parent extension concept and entity concept.

## 2 . Consolidation theories used in Japan recently

The remaining of this article, which theory of consolidation used in Japan recently to prepare CFS is studied. Each respect of consolidation is taken in to consideration to make conclusion. They include;

- 2.1 Report of investee's assets and liabilities, consolidation goodwill and minority interest in investee.
- 2.2 Elimination of unrealized inter-company profit or losses.

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7) Accountants International Study Group, op. cit., par.25.

8) John R.E. Parker, George C. Baxter, Irwin, Advanced Corporate Financial Reporting, A Canadian Perspective, 1990, pp.294-295.

Problem areas	Proprietary	Parent company	Parent company extension	Entity
1. Investee tangible assets, identifiable intangibles and liabilities.	Report investor proportionate share of fair value.	Report 100% of book value plus investor proportionate share difference between book value and fair value.	Report 100% of fair value allocated proportionately between majority and minority interest.	Report 100% of fair value allocated proportionately between majority and minority interest.
2. Invested goodwill	Report investor proportionate share (equal amount purchased)	Report investor proportionate share (equal amount purchased)	Report investor proportionate share (equal amount purchased)	Report 100% of fair value allocated proportionately between majority and minority interest
3. Unrealized inter-company gain or loss;				
a. Investor is the vendor (downstream transaction)	Elimination investor proportionate share (fractional elimination)	Elimination investor proportionate share (fractional elimination)	Elimination 100% against investor	Elimination 100% against investor
b. Invested is the vendor (upstream transaction)	Elimination investor proportionate share (fractional elimination)	Elimination investor proportionate share (fractional elimination)	100% elimination allocated proportionately between majority and minority	100% elimination allocated proportionately between majority and minority
4. Minority interest in investee				
a. At the time of acquisition	N/A	Report proportionate share of investee book value	Report proportionate share of fair value investee net identifiable assets	Report proportionate share of investee net assets
b. Subsequent consolidation	N/A	As above plus share of undistributed income (equals proportionate share of investee current book value)	As above plus share of investee undistributed income adjusted for effect of fair valuation of net identifiable assets and unrealized gains or losses	As above plus share of investee undistributed income adjusted for effect of fair valuation of net assets and unrealized gains or losses
5. Disclosure of minority interest in investee income	N/A	Deduction on consolidated income statement	Deduction on consolidated income statement	Deduction on consolidated statement of retained earning
6. Disclosure of minority interest in consolidated net assets	N/A	Creditor claim	Between liabilities and shareholders' equity	Part of shareholders' equity

Figure 1 Summary of basic consolidation concepts

2.3 Disclosure of minority interest.

2.4 Harmonization of accounting policies used by parent and its subsidiaries.

2.5 Other considerations.

2.6 In conclusion.

## 2.1 Report of investee's assets and liabilities, consolidation goodwill and minority interest in investee.

According to the revised consolidation accounting standards, report of investee's assets and liabilities, consolidation goodwill and minority interest in investee can be prepared by either partial fair value method or full fair value method alternatively.

Firstly, it is partial fair value method. Under this method "At each time of acquisition, the parent interest's proportion in subsidiary's net assets is valued at fair value, the proportion corresponding to minority interest is valued at book value"<sup>9)</sup>. Related to consolidation goodwill "In the case that difference occurs when reciprocal investment and equity account are eliminated, that difference is regarded as consolidation goodwill"<sup>10)</sup>. In other words, fair value is assigned only to extent of parent interest. The minority interest in subsidiary's net assets is determined base on the subsidiary's net assets at carrying value or book value. The consolidation goodwill is then computed by the difference between investment cost in subsidiary and parent's equity account in that subsidiary. As a result, no goodwill amount is assigned to minority interest. Clearly, this method corresponds with parent company concept when it is reconciled with figure 1.

Secondly, it is full fair value method. According to this method "On the date of being controlled, all acquired assets and liabilities are determined at fair value"<sup>11)</sup> and this amount are assigned not only to parent company but also to minority interest. As a result, subsidiary's all assets and liabilities at fair value are reported on consolidated balance sheet regardless whether minority interest exists or not. Then, the consolidation goodwill is measured by the same as those applied to partial fair value method; reported only to extent of parent company's ownership interest. Obviously, this method corresponds to parent company extension concept when it is reconciled with figure 1.

## 2.2 Elimination of unrealized inter-company profit or loss.

Before, in Japan "There was no regulation on how unrealized profit or loss was eliminated in the former consolidation standards"<sup>12)</sup>. Then, in order to guideline Japanese groups to prepare CFB in practice, Japanese Institute of Certified Public Accountants (JICPA) issued the Essential Procedures on Preparing Consolidated Financial Statements in 1976. This guideline pointed out that if profit or loss is generated from downstream transactions (parent sales merchandise to subsidiary), all unrealized profit will be eliminated and assigned to only parent company.

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9) 連結財務諸表原則，第四の 2 の 1。

10) 連結財務諸表原則，第四の 3 の 2。

11) 連結財務諸表原則，第四の 2 の 1。

12) 中村忠&小宮山賢，新連結会計入門，税務経理協会，1998年，p.117.

However, if unrealized profit or loss is generated from upstream transactions (subsidiary sales merchandises to parent company), one of these three methods can be used alternatively<sup>13)</sup>.

1. Method A, all unrealized profit or loss is eliminated and assigned to only parent company.
2. Method B, all unrealized profit or loss is eliminated and assigned to both parent company and minority interest proportionately.
3. Method C, only unrealized profit corresponding to parent interest is eliminated and assigned to parent company.

From this guideline, it can be recognized that parent company concept (method C) or parent extension company concept or entity concept (method B) was used in Japan to eliminate unrealized profit or loss generated from inter-company transactions. However, method A did not correspond with any consolidation theory. In practice, JICPA advised Japanese groups applying either method B or method C. How did Japanese groups apply this guideline to practice? Exhibit 1 shows out a number of groups using different methods to eliminate unrealized profits in Japan during the period from 1995 to 1999.

The exhibit 1 presented clearly that methods used to eliminate unrealized profits or losses in Japan in the past were inconsistent among groups. This resulted from default of former consolidation standards, which were not strict. That situation not only caused the comparative principle broken but also made Japanese consolidated financial statements distrusted. Current consolidation standard requires that “All unrealized profit contained in fixed assets, inventory, which are generated from inter-company transactions, must be eliminated”<sup>15)</sup>. Thus, in comparison with the former standard, method C is no longer accepted. Next, “In the case if seller is subsidiary and minority exists, unrealized profit assigned to parent and minority interest accord-

	1995	1996	1997	1998	1999
(1) All unrealized profits or losses eliminated and assign to both parent and minority interest (method B)	225	227	237	250	250
(2) All unrealized profits or losses eliminated and assigned to only parent (method A)	142	139	129	132	115
(3) A partial unrealized profits or losses eliminated and assigned only to parent (method C)	40	42	45	34	38
(4) Up to inter-transactions of classified assets, either method C or method B used alternatively.	4	4	4	4	4
(5) Unrealized profit or losses assigned not clearly	59	59	54	49	61
(6) As unrealized profits or losses not material or no unrealized profit occurring, not need being eliminated	3	3	4	6	5

Exhibit 1 Elimination unrealized profits under the former consolidation standard<sup>14)</sup>

13) 日本公認会計士協会, 連結財務諸表作成要領, 1976年, 第5の5。

14) 日本公認会計士協会, 決算開示トレンド, 平成13年版, p.505.

15) 連結財務諸表原則, 第5の3の1。

ing to their proportionate shares”<sup>16)</sup>. Thereof, according to the current standard, method A is not admitted any more. In conclusion, the methods used for eliminating unrealized profit and loss can be classified in two cases;

- (1) Case 1 —downstream. All unrealized profit or loss is eliminated and assigned to only parent company.
- (2) Case 2 —upstream. All unrealized profit or loss is eliminated and assigned to parent and minority interest based on their proportionate shares.

If these cases are reconciled with figure 1, eliminating unrealized profit or loss in Japan corresponds with either parent extension company concept or entity concept. Moreover, this regulation enable to stop the turmoil situations by forbidding use differently alternative methods to eliminate unrealized profits or losses like in the past, which has just been showed out in the exhibit 1.

### 2.3 Disclosure of minority interest

There are many opinions about disclosure of minority interest on consolidated balance sheet. The reason why there are so many methods comes from complicated, diversified characters of minority interest itself. So far, there have been three methods of disclosure of minority interest on consolidated balance sheet. Each method is explained below.

The first method showed minority interest as a liability item. This method is based on parent company concept, which considers minority interest as an outsider of the group. Moreover, in practice, when minority's portion in subsidiary's equity is minus, parent company has to bear this minus for minority interest; as a result, parent company's equity is deducted on consolidated on consolidated balance sheet. Current consolidation standards also pointed out that “If loss of related subsidiary allocated to minority interest is over than minority interest's share in subsidiary, parent company must bear this over amount”<sup>17)</sup>.

The second method shows minority interest as a part of consolidated stockholder's equity section. This method is based on the equity concept. According to this method, both parent company's stockholders and minority interest are treated consistently and equally. As both these parties contribute subsidiary's equity, both parent's equity and minority interest are presented in consolidated equity section. The problem occurs when this second method approached is that how minority interest is disclosed on consolidated balance sheet. There are two solutions; one is that mixing up parent company's entity and those of minority interest and then reporting the total amount, the another one is that reporting parent company's entity and minority interest one separately. For the former solution, it is suitable to entity concept by

16) 連結財務諸表原則，第 5 の 3 の 3。

17) 連結財務諸表原則，第四の四の 2。

showing no difference between minority interest and parent company's shareholders. However, users of consolidated balance sheet may make mistakes by understanding that all consolidated equity belongs to parent's shareholders. For the latter solution, it prevents the disadvantages of the former one; however, it violates entity concept by reporting parent interest and minority interest separately in consolidated equity section.

The third method shows minority interest as separated item between liability and consolidated stockholders' equity. Because minority interest carries both liability and equity characters, it is not perfect to disclosure minority interest in either liability section or equity one. The disadvantage of reporting minority interest in liability section is that "It is not a liability in legal sense, because it does not need to be paid"<sup>18)</sup>. On the other hand, reporting minority interest in the consolidated equity also has some disadvantages, which have been addressed above. In addition, even both these parties contribute subsidiary's equity, their roles in subsidiary's business operations are not the same; while parent can control subsidiary's business operations, minority interest cannot obtain that right. It is not easy to show which one is more advance than another in every situation. In fact, almost CFS nowadays are prepared based on mixed-up consolidation theories. For above reasons, minority interest is reported as a separated item lied between liability section and consolidated stockholders' equity "In process of consolidation, from parent company concept and entity concept's point of view, minority interest is thought to be neither liability nor equity. It is convenient in practice that minority interest is disclosed between liability and equity"<sup>19)</sup>.

In Japan, current consolidation standard addresses that "Minority interest is showed as a separated item after liability section"<sup>20)</sup>. If this regulation is reconciled with the figure 1, disclosing minority interest in Japan corresponds with parent extension company concept.

In addition "Although minority interest's net income or losses are reported on consolidated income statement, current consolidated net income is calculated for only parent company's shareholders"<sup>21)</sup>. As showed, minority interest's income is considered as a deduction item on consolidated income statement. Thus, this way of reporting corresponds with either parent company concept or parent extension company concept.

#### 2.4 Harmonization of accounting policies used by parent and its subsidiaries

Different accounting policies can be used by parent and its subsidiaries within one group, in order to give a meaningful picture of a group and give a true and fair view of result and the financial position, CFS must be prepared on the basis of unified accounting policies.

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18) John V.R Anderson, Consolidated Account, The Accountant, 1975, p.24.

19) 稲垣富士男, 連結財務諸表詳解, 中央経済者, 1975年, p.120.

20) 連結財務諸表原則, 第四の9の1。

21) 連結財務諸表青制度の見直しに関する意見書, 第二部の二の2。

According to the former consolidation standards, individual financial statements used to prepare CFS must be harmonized with general accepted accounting principles; if not, adjustments are needed on process of preparing CFS. Then “accounting policies and procedures used by subsidiary must be harmonized with those used parent as much as possible”<sup>22)</sup>. The weaknesses of this regulation can be summarized briefly as follows.

In the first place, the regulation was not strict. This caused many CFS prepared in Japan ago without harmonizing accounting policy demand. Exhibit 2 shows out this mood from 1995 to 1998.

Second, former consolidated standards focused on parent’s stockholders rather than the economic substance of the whole group. The evidence is that accounting used by parent, regardless whether they can reflect better financial picture and net result of the whole group or not, must be chosen as standard accounting for harmonization. When parent company concept is applied, as it emphasizes only parent company in the group, for this “the selected accounting policies for the same transactions is not freely possible, it is certainly that accounting used by parent must be used as standard accounting policy to harmonize”<sup>23)</sup>.

In order to overcome the weaknesses of the former consolidation standards, the revised consolidation standards points out “Under the same circumstances and the same transactions, accounting policies used by parent and its subsidiaries must be harmonized”<sup>25)</sup>. Related to accounting procedures chosen for harmonization, regardless accounting policies used by either parent or subsidiaries, if the results generated from using that accounting policies reflect better financial position and net income of the whole group, that accounting policies will be chosen as accounting standard for harmonization. Current practice in Japan follows this rule.

This new rule enables to stop the disordered situation showed above. Moreover, selected accounting policies, which reflect better the financial position and the net income of the whole group without considering that accounting policies used by parent or subsidiaries, improves that entity concept is approached.

	1995	1996	1997	1998
(1) The methods used to value security; harmonizing	376	371	414	416
not harmonizing	49	51	61	59
(2) The methods used to value inventories; harmonizing	305	301	334	335
not harmonizing	120	119	137	136
(3) The methods used to make allowances; harmonizing	348	343	385	384
not harmonizing	42	42	67	68
(6) The methods used to make retirement allowances; harmonizing	282	284	279	276
not harmonizing	140	139	127	130

Exhibit 2 Situation of harmonizing or not harmonizing accounting used by parent and its subsidiary<sup>24)</sup>.

22) 1975年の連結原則，第三の三。

23) 花堂靖仁，連結財務諸表の作成と会計方針の統一について，企業会計，1997年，Vol.49，No.1，p.37.

24) 日本公認会計士協会，決算開示トレンド，中央経済社，平成11年版，p.537.

25) 連結財務諸表原則，第三の三。

## 2.5 Other considerations

In this section, two issues are taken in to consideration. The first issue is that reporting the difference between the parent interest's decreased portions and the proceeds from sale a portion of its subsidiary's common stock. The second issue is that reporting the difference between the parent interest's decreased portion and the increased one from more common stocks issued by subsidiary to outsiders.

In the first place, it is the former issue. The difference between proceed from sale and the parent's decreased portion on consolidation is treated in different ways according to different consolidation concepts. Under parent company concept, minority interest is considered as outsider of the group. For this, when parent company sales a portion of subsidiary's stocks, this difference is treated as consolidated gains or losses regardless whether parent—subsidiary relationship is remained after sale or not.

Whereas, under entity concept "From a consolidated viewpoint, the subsidiary shares become part of non-controlling interest outstanding at the point they are sold to non-affiliate. If no gains or losses are recognized when stock is issued by a single company, non should be recognized when stocks is issued by a company within a consolidated entity"<sup>26)</sup>. In short, under entity concept, this difference is not reported on consolidated income statement.

In Japan, "...The difference between parent interest's decreased portion and decreased portion of investment cost is used to adjust gain or loss on sale of investment..."<sup>27)</sup>. Clearly, this regulation corresponds with parent company concept.

Secondly, it is latter issue. The difference between parent's increased portion and decreased portion from more common stocks issued by subsidiary to outsiders is either as gains, losses or as consolidated paid-in-capital. The basement for gains or losses is parent company concept regarding minority interest as outsiders of the group. While direct sales of stock by the parent records that difference as gain or loss, the difference from subsidiary stock sales that reduce a parent's investment must be also recorded as gain or loss, too. On the other hand, under the entity concept, both parent and minority interest are considered as members of single economic and "The sale of additional shares to unaffiliated parties by a subsidiary and a sale of subsidiary by the parent are similar transactions; in both cases, the consolidated entity sells shares to non-controlling interest... The recognition of a gain or loss on such a transaction seems inappropriate because the sale of stock to unaffiliated parties by the consolidated entity is a capital entity transaction from a single-entity viewpoint"<sup>28)</sup>.

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26) Richard E. Baker, Valdean C. Lembke, Thomas E. King, *Advanced Accounting*, Irwin McGraw-Hill, 1999, p. 505.

27) 連結財務諸表原則, 第四の5の2。

In Japan, problems related to subsidiary issuing more share are showed that “The similar problems related to subsidiary issuing more shares, the remaining of contributed amount paid by parent company after reduced by the difference between parent’s increased portion and decreased portion is regarded as gains or losses. However, it is admitted that if do so, readers of CFS mistake remarkably, the above remaining is recorded as consolidated paid-in capital”<sup>28)</sup>. From this regulation, it is clear that the first treatment corresponds to parent company concept; the second one corresponds with the parent company extension concept or entity concept.

## 2.6 In conclusion

Figure 2 summaries the basic respects used to classify on which consolidation theories are used in Japan currently to prepare CFS.

As showed in the figure 2, consolidation in Japan is mixed up parent company concept, parent company extension concept and entity one. While no one of four theories has been adopted purely by the Japanese accounting profession, it seems that tendency of consolidation theory used in Japan slants parent company extension and entity concepts rather than parent company concept like the following figure;

<u>Problem areas</u>	<u>Contents</u>	<u>Consolidation theory</u>
1. Report investee’s assets and liabilities.	1. Partial fair value method. 2. Full fair value method.	Parent company concept. Parent company extension concept.
2. Investee goodwill.	Report only to extension of parent company.	Parent company concept or parent company extension concept.
3. Unrealized inter-company gain or loss.		
a. Down-stream transactions.	Eliminating 100% against investor.	Parent company extension concept or entity concept.
b. Up-stream transactions.	100% eliminated and assigned to parent and minority interest proportionately.	Parent company extension concept or entity concept.
4. Minority interest in investee.		
a. At the date of acquisition	1. Reporting proportionate share of investee’s book value. (partial fair value method) 2. Reporting proportionate share of investee’s net assets at fair value. (full fair value method)	Parent company concept. Parent company extension concept

Figure 2 Summary of basic consolidation concept used in Japan (continue)

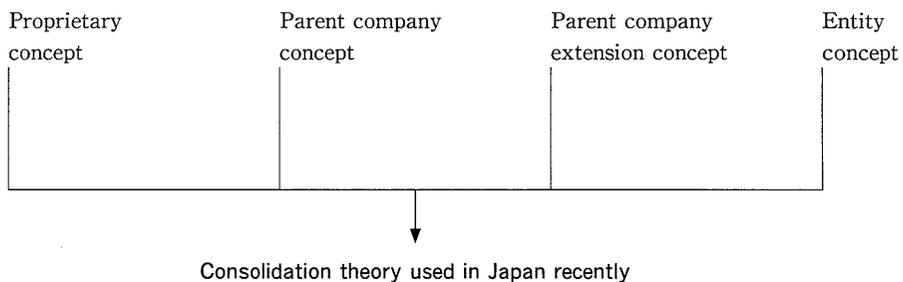
28) Richard E. Baker, op. cit., p.509.

29) 連結財務諸表原則，第四の 5 の 3。

<u>Problem areas</u>	<u>Contents</u>	<u>Consolidation theory</u>
b. Disclosure minority interest on consolidated balance sheet.	As a separated item between liability and shareholder's equity.	Parent company extension concept.
c. Disclosure minority interest on consolidated income statement	As a deduction item on consolidated income statement.	Parent company concept or parent company extension concept.
4. Other considerations.		
a. Reporting the difference between parent interest's decreased portion and proceed from sale a part of subsidiary's common stock.	As profit or loss on consolidated income statement.	Parent company concept.
b. Reporting the difference between parent interest's decreased portion and increased one from more common stocks issued by subsidiary.	1. Treated as profit or loss consolidated on income statement.	Parent company concept.
	2. Treated as an item added or subtracted to consolidated paid-in capital.	Parent company extension concept or entity concept.
c. Choosing accounting policy for harmonization.	Accounting policy, which presents financial picture and net income of the whole group best regardless that accounting policy used by either parent or its subsidiary.	Entity concept.

Figure 2 Summary of basic consolidation concept used in Japan

The figure above not only points out the consolidation theory used in Japan but also improves that what BADC giving out its opinion presented on the page 1 of this article should be reconsidered.



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